

Message Text

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ACTION EUR-12

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S E C R E T LISBON 6641

DEPT. PASS TREASURY FOR SYVRUD

E.O. 11652: GDS
TAGS: EFIN, ECON, PO
SUBJ: PRIME MINISTER ANNOUNCES NEW ECONOMIC MEASURES

REF: (A) LISBON 6628, (B) LISBON 6636

1. ECONOMIC COUNSELOR MET MORNING OF AUGUST 26 WITH PROMINENT LEADERS OF GOVERNMENT BANKING SECTOR. DISCUSSION CONFIRMED THAT POLITICAL CONSIDERATIONS STRONGLY INFLUENCED FORMULATION OF DECISIONS ANNOUNCED AUGUST 25 BY PRIME MINISTER SOARES.

2. DURING GOP DISCUSSIONS OF DEVALUATION ISSUE, PORTION OF ECONOMIC TEAM LED BY MINISTER OF FINANCE AND BANK OF PORTUGAL PROPOSED IMMEDIATE DEVALUATION OF SIX TO EIGHT PERCENT FOLLOWED BY CRAWLING PEG. THESE MEN HAD NOT SOUGHT LARGER DEVALUATION BECAUSE THEIR DATA REPORTEDLY SHOWS THAT PORTUGAL'S CURRENT EXPORT COMPETITIVENESS IS EQUAL TO THAT OF 1973. (EMBASSY SERIOUSLY DOUBTS THAT DATA ON WHICH STUDY BASED ARE ACCURATE. IN ADDITION, STUDY DID NOT TAKE ACCOUNT OF STRUCTURAL CHANGES SINCE 1973, E.G. LOSS OF COLONIES.) MINISTER OF INDUSTRY, WHO IS AN ENGINEER RATHER THAN AN ECONOMIST, ARGUED AGAINST DEVALUATION ON GROUNDS THAT PORTUGUESE EXPORTERS ARE NOT REQUESTING IT. PM MADE FINAL DECISION NOT TO
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DEVALUE IMMEDIATELY, CLAIMING THAT POLITICAL COSTS WOULD BE TOO HIGH FOR THE RELATIVELY SLIGHT DEGREE OF DEVALUATION PROPOSED. HE OPTED INSTEAD FOR DISCREET, RELATIVELY SMOOTH, CRAWL.

3. PROPOSAL FOR FOUR PERCENTAGE POINT INCREASE IN INTEREST RATE CAME FROM BANK OF PORTUGAL. BANK HAD ORIGINALLY

CONSIDERED A SIX PERCENTAGE POINT INCREASE, BUT SUBSEQUENTLY LOWERED THIS FIGURE BECAUSE IT FEARED SPARKING A SIGNIFICANT CONTRACTION OF THE ECONOMY. IT ANTICIPATES ANOTHER RISE IN INTEREST RATES TOWARD THE END OF THE YEAR.

4. MEASURES ANNOUNCED BY PM ARE NOT LIKELY TO FACILITATE PORTUGAL'S FORTHCOMING NEGOTIATIONS WITH IMF. A FUND DELEGATION IS EXPECTED TO VISIT PORTUGAL FOR ONE WEEK BEGINNING SEPTEMBER 19. SUBSEQUENT DISCUSSIONS ARE EXPECTED TO TAKE PLACE IN WASHINGTON DURING ANNUAL FUND/WORLD BANK MEETING. GOP ECONOMIC TEAM MEMBERS ACKNOWLEDGE THAT GOP WILL EVENTUALLY HAVE TO ACCEPT HARSHER ECONOMIC POLICIES IN ORDER TO ACHIEVE SECOND TRANCHE STANDBY AGREEMENT, EVEN THOUGH DECISION WILL BE MORE DIFFICULT TO TAKE IN OCTOBER THAN WOULD HAVE BEEN TRUE NOW.
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